SUPREME COURT, U. S.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1968

FIRST NATIONAL INDUSTRIES, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner prays that writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit, entered December 26, 1968, affirming a judgment of the Tax Court of the United States that there were deficiencies in income tax due from petitioner for the taxable years ended January 31, 1957 and January 31, 1959, in the amounts of $8,324.21 and $152,024.93, respectively.

Opinion Below

The opinion of the Tax Court, T. C. Memo 1967-136, is not officially reported. The opinion of the United States Court of Appeals for the Sixth Circuit is reported at 404 F. 2d 1182 (1968).

Jurisdiction

The judgment of the Court of Appeals was entered on December 26, 1968. The jurisdiction of the Court of Appeals was invoked under 26 U. S. Code, § 7482. The jurisdiction of this Court is invoked under 28 U. S. Code, § 1254.

Question Presented

Whether any amount is "realized" from the transfer of the equity in property, where the transferor remains primarily liable on the obligation which the property secures, and pays such obligation in the taxable year following that in which the transfer was made.

Statute Involved

26 U. S. Code § 1001(b) provides:

> "(b) Amount Realized.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. . . ."

Statement

Petitioner is a business corporation, 87% of the outstanding stock of which was owned by First National Company, a holding company. First National Company also owned all or most of the stock in a number of other business corporations. The common stock of First National Company was owned by Church of Christ Foundation, Inc., a

non-profit charitable corporation. After pledging 1,000 shares of stock in an entirely separate company with a bank as collateral for a $750,000 loan, petitioner transferred this stock to the Foundation. The stock certificate was temporarily surrendered by the bank for transfer, and the Foundation then repledged the stock to the bank as security for petitioner's indebtedness. Subsequently, the Foundation sold the stock to the issuing company for part cash and a note, and later sold the note to the bank for $700,000, which sum it advanced to First National Company. The latter company then made payments of debts owed to three of its subsidiaries, and they in turn paid $700,000 to petitioner in payment of indebtedness to petitioner. With this money petitioner paid off its note to the bank. These facts are undisputed and are substantially so stated in the Court's opinion.

The Tax Court and the Court of Appeals, relying upon *Crane* v. *Commissioner*, 331 U. S. 1 (1947), held that because the aforesaid shares of stock were "subject to" the bank indebtedness when transferred, it was immaterial that petitioner remained primarily liable on the obligation to the bank; and both courts held that under Section 1001(b) of the Internal Revenue Code, petitioner "realized" the amount of the indebtedness, on the theory that, in the language of the Court of Appeals, the transfer of the stock was "basically equivalent to a sale." The following quotations from the opinion of the Court of Appeals succinctly state the basis for its decision:

> ". . . Since the amount of the mortgage on property is part of its sale price even though the purchaser does not assume the mortgage (*Crane* v. *Commissioner*, 331 U. S. 1 (1947), because the purchaser will be required in some way to discharge the mortgage, a transfer of property subject to such a mortgage may

in substance constitute a receipt by the transferor of the amount of the mortgage on the property if the transferee does in fact pay the indebtedness secured by the mortgage. Petitioner argues that since the Foundation did not here in fact pay the note secured by the B. G. Wholesale, Inc. stock transferred to it by petitioner, the foregoing principal is without application. This argument must depend upon petitioner's self-serving statement that it contributed *the stock* to the Foundation and not merely *petitioner's equity* in the stock. All petitioner had, however, at that time was the ability to contribute its equity in view of the fact that the stock was pledged with the bank to secure the $750,000 note, and the passage of a resolution by petitioner's board of directors could not alter that fact.

"Petitioner remained the obligor on the note and ultimately paid the note with funds which came into its hands from the sale of the stock. However, this indirect advance by the Foundation to petitioner of funds with which the note to which the stock was affixed as security did not occur until after the end of petitioner's fiscal year (January 31, 1959). Thus while the transfer of the stock occurred within the taxable year with which we are here concerned the Foundation did not hold the stock free of its assignment to the bank as security for petitioner's loan at any time within that year. Stated differently, at no time during the taxable year in question did the Foundation possess more than petitioner's equity in the subject stock. In spite of the ramifications and complexities of the intracorporate transactions, so far as the purported gift to the Foundation is concerned in the last analysis we find a situation no different than that which would have existed had petitioner made a 'gift' to a stranger of the stock while pledged as security on the note. In such instance it is clear that the donee could take no more interest than that possessed by the donor, and in the present circumstances the Foundation can acquire

only that interest. We hold that the determination of the Tax Court that the transaction whereby petitioner transferred the stock to the Foundation was a sale by petitioner of the stock for an amount of at least $700,000 and that petitioner thereby realized a capital gain from the transaction in its fiscal year ended January 31, 1959, to be supported by substantial evidence and not clearly erroneous."

Reasons for Granting the Writ

1. The decision of the Court of Appeals rested upon a misconception of the doctrine of *Crane* v. *Commissioner, supra,* and is in conflict with the basic principles underlying that decision. In *Crane,* the taxpayer sold property subject to a mortgage on which the taxpayer was *not* individually liable. The amount "realized" included the amount of the indebtedness, as well as the cash payment made by the purchaser. Here the taxpayer was liable and remained liable on the indebtedness and ultimately paid it off with its own funds.

2. The rationale of the decision below applies (as the Court of Appeals made quite plain) to any transfer, even to a "stranger," of the "equity" in property which is pledged or mortgaged. This would include a type of gift used in estate planning: parents give the equity in pledged or mortgaged property to children, and make annual payments on the debt in later years so as to take advantage of the annual gift tax exclusion under Internal Revenue Code Section 2503(b). Under this decision, the initial gift will result in a tax on the amount of the debt minus the basis of the donated property,—a tax never contemplated by Congress, and never suggested in any prior judicial decision.[1]

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1. A somewhat similar set of facts was involved in *Foley* v. *Allen,* 170 F. 2d 434 (5 Cir. 1948), where the donor died before paying off the debt, and it was held that a completed *inter vivos* gift of the pledged shares of stock had been made. The case involved only estate taxes—the income tax people were presumably not concerned.

Charitable gifts of the same type are not uncommon. In view of the wide impact of the decision, it should be reviewed by this Court.

Conclusion

For the foregoing reasons, the petition for certiorari should be granted.

Respectfully submitted,

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No. 18,208

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

FIRST NATIONAL INDUSTRIES, INC., *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

On Petition for Review of Decision of the Tax Court of the United States.

Decided December 26, 1968

Before: Peck, McCree and Combs, Circuit Judges.

Peck, Circuit Judge. A preliminary statement of the facts of this case in summary form may be of assistance. This appeal from the Tax Court results from its allowance of a deficiency assessment made on the basis of what the Commissioner contends (and the Tax Court found) to be a capital gain. The taxpayer is one of six corporations owned or controlled by a seventh, itself a nonprofit charitable[1] corporation. After pledging a thousand shares of

1. This corporation (Church of Christ Foundation, Inc.) was ruled exempt from tax under Section 101(6), Internal Revenue Code of 1939, by letter of respondent dated January 5, 1948. However, by letter dated March 6, 1961, the Chief, Exempt Organizations Branch, Tax Rulings Division of the Internal Revenue Service, advised that the Service was proposing to issue a ruling holding that the corporation was not exempt under Section 501(c)(3), Internal Revenue Code of 1954. By letter dated November 14, 1961, the Director of the Tax Rulings Division, IRS, advised the corporation that its exemption had been revoked retroactively to the year 1955. The status of the corporation is not in issue here, there being no present contention that petitioner is entitled to a deduction on account of a donation to a charitable organization.

stock in an entirely separate company with a bank as collateral for a $750,000 loan, it "gave"[2] the stock to its parent (charitable) corporation. The latter thereafter sold the stock to its issuing company and pledged that company's note to secure taxpayer's bank indebtedness. The charitable corporation subsequently sold that note to the bank for $700,000, advanced that sum to one of the other companies (100% of whose stock is owned) which then made payments to three of the other subsidiaries to pay off indebtedness, and they in turn paid the $700,000 to taxpayer on account of their obligations to it. Taxpayer then paid off its note to the bank with the $700,000.

The Tax Court found that all plaintiff contributed to its parent charitable corporation was its equity in the stock since it remained pledged to the bank, and further found that taxpayer had realized a $600,000 capital gain. This figure was reached by crediting the $100,000 basis on which petitioner held the stock against its $700,000 valuation at the time of the transfer.

Respondent determined a deficiency in petitioner's income tax for the fiscal year ending January 31, 1959, in the amount of $152,024.93 on the basis of the determination that petitioner realized a long-term capital gain on the transfer of stock hereinabove mentioned. That stock consisted of 1,000 shares of B. G. Wholesale, Inc. That corporation had been formed by G. L. Comer and Ervin G. Houchens, on the basis of a cash contribution in the amount of $100,000 by Comer and of certain stores and stock in trade of a total valuation of $100,000 by Houchens. This corporation operated retail grocery stores under the name of Houchens Markets, and following its incorporation

2. It is the character of this transaction which is at the heart of the principal issue presented; petitioner claims this to have been a gift, while respondent contends it was merely a transfer.

in 1944 Comer transferred the 1,000 shares of stock received for his corporation to several corporations controlled by him. In 1948 they were transferred to First National Company which at that time Comer owned, and in 1950 that company transferred the shares to Merchants Warehouse Company, also owned by Comer, for $100,000, and in 1955 it transferred the shares to petitioner for $100,000.

On December 10, 1957, petitioner obtained a loan of $750,000 from the First American National Bank in Nashville, Tennessee, on a note secured by the pledge of the 1,000 shares of common stock in B. G. Wholesale, Inc. Its books and records reflect that that stock was donated by it to Church of Christ Foundation, Inc. (hereinabove referred to as a nonprofit charitable corporation and hereinafter as the Foundation) on February 28, 1958. On that date petitioner's board of directors passed a resolution directing a transfer of the stock to the Foundation, and on the same day the trustees of the Foundation passed a resolution pledging the shares to the First American National Bank of Nashville to secure petitioner's indebtedness. The stock was transferred into the Foundation's name on the books of the issuing corporation, having been temporarily released by the bank so that this transfer could be made.

At all pertinent times since its incorporation in 1955, 87% of the outstanding stock of the petitioner was owned by First National Company, a private business corporation, the common stock of which was owned by the Foundation. This corporation was a holding company and among its holdings were the entire outstanding capital stock of four garment manufacturing corporations, Blue Ridge Shirt Mfg. Co., Dixie Mfg. Co., Mammoth Cave Garment Co. and McEwen Mfg. Co. Petitioner owned garment making machinery which it leased to these manufacturing companies.

The Foundation sold the stock in question to the issuing corporation, B. G. Wholesale, Inc., for redemption on May 31, 1958, pursuant to a contract of sale dated May 27, 1958. The redemption price was $955,374.29 of which $250,000 was paid in cash and a promissory note was executed for the balance in the amount of $705,374.29. The Foundation promptly paid the $250,000 to First National Company, to be applied on its indebtedness in a larger amount to this subsidiary corporation. First National Company, in turn made payments on indebtedness it owed to the four manufacturing corporations above referred to, which then paid, in the aggregate, $250,000 owing by them to the petitioner. Petitioner, in turn, made its payment of $250,000 on the note to the bank. Thus a series of debts were reduced or liquidated by this money, but this series of transactions are not directly involved in this action. Additionally, petitioner had made a payment on this note in the amount of $100,000, so that the remaining balance was $400,000.

On October 9, 1958, petitioner consolidated the $400,000 note with another outstanding note in the amount of $200,000, and received $100,000 of newly borrowed cash. Subsequently, in a taxable year not before the Court, the Foundation sold the $705,374.29 note executed by B. G. Wholesale, Inc., to the bank, and out of the proceeds of that sale advanced $700,000 to its subsidiary, First National Company, thereby initiating a second series of payments. It in turn made payments in this aggregate amount to three of the four manufacturing corporations above referred to and in payment of indebtednesses. They in turn paid an aggregate of $700,000 on their indebtednesses to the petitioner, and it paid off its note to the bank in the amount of $700,000. It is this $700,000 which respondent contends was realized by petitioner from the "gift" of the stock to the Foundation on February 28, 1958, and which

resulted in a capital gain of $600,000, since as demonstrated above, it held the stock on a $100,000 basis. In her findings of fact the tax judge pointed out that the books and records of petitioner and the other companies owned or controlled by Comer or the Foundation with which it had transactions "were kept in the ordinary courses of the respective businesses . . . and the various entries were made in the ordinary courses of business of those corporations." The findings point out that these corporations had intercompany transactions resulting in indebtednesses and that they customarily borrowed from or made advances to one another. Judge Scott further made this specific finding:

> "The revenue agent who examined the books and records of the Foundation and of petitioner and of a number of the other corporations referred to in these findings found the books and records of the various corporations in excellent shape and found intercompany transactions meticulously reported. He found no attempt to cover up or hide any transactions. Payments by one of the various companies to another of those companies, including those heretofore set out, were made by checks drawn on the bank account of the company making the payment."

As is apparent from the foregoing, that an appreciation in the value of the B. G. Wholesale, Inc. stock occurred is not in question. The success and the expansion of the Houchens Markets brought about this increase in value, and buy or sell offers between Comer and Houchens followed. It was the acceptance of such an offer that resulted in the redemption of the stock at a price determined under a formula which was a part of the contract.

Had the Foundation formally assumed taxpayer's $700,000 debt and paid it off, there would have been no question but that there would have been a taxable event

and a realization of income by petitioner. However, it is to be noted that although the Foundation did not formally assume petitioner's indebtedness to the bank, it took the B. G. Wholesale, Inc. stock subject to the indebtedness under circumstances, the Tax Court found, amounting to "an understanding and agreement that in effect the stock or proceeds from its sale would be used to discharge petitioner's indebtedness to the bank. . . ."

Where a taxpayer, to discharge an obligation, transfers property which has appreciated in value a gain from the transfer is realized to the extent that the value of the obligation discharged exceeds his basis in the property. A donor taxpayer is not chargeable for income on account of a gift of property which has appreciated in value over the base at which he held it (*Humacid Co.*, 42 T.C. 894, 913 (1964)), but where donated property continues to be subject to a mortgage a gain may result to the donor under certain circumstances. *Joseph B. Simon*, 32 T.C. 935 (1959), *aff'd*, 285 F.2d 422 (3rd Cir. 1960). Since the amount of the mortgage on property is part of its sale price even though the purchaser does not assume the mortgage (*Crane* v. *Commissioner*, 331 U.S. 1 (1947)), because the purchaser will be required in some way to discharge the mortgage, a transfer of property subject to such a mortgage may in substance constitute a receipt by the transferor of the amount of the mortgage on the property if the transferee does in fact pay the indebtedness secured by the mortgage. Petitioner argues that since the Foundation did not here in fact pay the note secured by the B. G. Wholesale, Inc. stock transferred to it by petitioner, the foregoing principal is without application. This argument must depend upon petitioner's self-serving statement that it contributed *the stock* to the Foundation and not merely *petitioner's equity* in the stock. All petitioner had, however, at that time was the ability to contribute its equity in

view of the fact that the stock was pledged with the bank to secure the $750,000 note, and the passage of a resolution by petitioner's board of directors could not alter that fact.

Petitioner remained the obligor on the note and ultimately paid the note with funds which came into its hands from the sale of the stock. However, this indirect advance by the Foundation to petitioner of funds with which the note to which the stock was affixed as security did not occur until after the end of petitioner's fiscal year (January 31, 1959). Thus while the transfer of the stock occurred within the taxable year with which we are here concerned the Foundation did not hold the stock free of its assignment to the bank as security for petitioner's loan at any time within that year. Stated differently, at no time during the taxable year in question did the Foundation possess more than petitioner's equity in the subject stock. In spite of the ramifications and complexities of the intracorporate transactions, so far as the purported gift to the Foundation is concerned in the last analysis we find a situation no different than that which would have existed had petitioner made a "gift" to a stranger of the stock while pledged as security on the note. In such instance it is clear that the donee could take no more interest than that possessed by the donor, and in the present circumstances the Foundation can acquire only that interest. We hold that the determination of the Tax Court that the transaction whereby petitioner transferred the stock to the Foundation was a sale by petitioner of the stock for an amount of at least $700,000[3] and that petitioner thereby realized a capital gain from the transaction in its fiscal year ended January 31, 1959, to be supported by substantial evidence and not clearly erroneous.

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3. Respondent is not contending for any greater capital gain than the $600,000 as determined in the notice of deficiency.

Our determination that the principal transaction herein involved is basically equivalent to a sale (Section 1001 of the Internal Revenue Code of 1954), makes it unnecessary to consider the further contention of the government that the transfer of stock to the Foundation was a distribution in kind resulting in a taxable gain under Section 311(c) of the Internal Revenue Code of 1954.

Affirmed.

T. C. Memo. 1967-136

TAX COURT OF THE UNITED STATES

FIRST NATIONAL INDUSTRIES, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 389-63 Filed June 23, 1967

(Findings of Fact Omitted)

Opinion

Respondent takes the position that in substance the sale of the B. G. Wholesales, Inc., stock by the Foundation was a sale by petitioner and therefore the gain is that of petitioner. However, in accordance with the stipulation of the parties, respondent is not contending for any greater gain than the $600,000 as determined in the notice of deficiency. Respondent's alternative position is that petitioner's transfer of the B. G. Wholesale, Inc., stock to the Foundation, subject to petitioner's loan at the bank resulted in a gain to petitioner to the extent that the loan exceeded petitioner's basis in the stock.

Petitioner maintains that the B. G. Wholesale, Inc., stock was donated to the Foundation on February 28, 1958, to enable the Foundation, which at that time it considered to be an exempt organization, to use the dividends from the stock as a supplement to the cash donations it received to maintain or increase the amount of its contribution to churches and their charitable and educational affiliates. It is petitioner's position that at the time it donated the stock to the Foundation there existed no agreement for the sale of the stock, that the ultimate sale of the stock was negotiated and carried through by the Foundation, and that the gain was that of the Foundation and not of petitioner. Petitioner contends that it realized no income upon the transfer of the stock to the Foundation even though the stock remained pledged with the First American National Bank of Nashville as security for petitioner's loan. Petitioner argues that since it remained liable on the note and the Foundation neither assumed nor ultimately paid the indebtedness for which the stock was pledged, no income could result upon the transfer of the stock subject to the liability. It is petitioner's position that it is immaterial whether in fact the Foundation was an exempt organization at the time the transfer was made since petitioner's belief that it was such an organization was sufficient to show a donative intent on the part of petitioner upon the transfer of the stock and thus cause the transfer to be one which resulted in no gain to petitioner.

There are a number of cases dealing with whether gain is taxable to the transferor of property which is sold by the transferee immediately after its transfer. In many of these cases, relying on *Commissioner* v. *Court Holding Company*, 324 U.S. 331 (1945), and the numerous cases applying the principle announced therein, the Commissioner contends as he does here that al-

though in form the sale is made by the transferee, in substance it is the sale of the transferor. Where a contract of sale has been negotiated prior to the transfer, the cases generally consider the sale in substance to be that of the transferor. *Commissioner* v. *Court Holding Company, supra; John E. Palmer,* 44 T.C. 92 (1965), affirmed per curiam, 354 F. 2d 974 (C.A. 1, 1965); and *Harry C. Usher, Sr.,* 45 T.C. 205 (1965). Where the transferor has entered into negotiations with respect to a sale but no contract of sale has resulted from these negotiations, the sale is generally not considered to be that of the transferor unless other circumstances are such as to indicate a lack of substance in the transaction. *Oahu Beach & Country Homes, Ltd.,* 17 T.C. 1472 (1952), and *Sheppard* v. *United States,* 361 F. 2d 972 (Ct. Cls., 1966). From the facts in the instant case, we conclude that although petitioner's officers were aware at the time the stock was transferred to the Foundation that it was quite likely to be sold to Houchens or redeemed by the corporation in the near future, there did not exist any contract for the sale of the stock at the date of its transfer. Under these circumstances, had there been no encumbrance on the stock when it was transferred and were we to conclude that the stock was a bona fide contribution to the Foundation or a dividend to the indirect owner of 87 percent of petitioner's stock, we would agree with petitioner that no gain resulted to it from the transfer. If no encumbrance were on the stock when it was transferred, it would be immaterial in this case whether the transfer of the stock was a contribution or a payment to petitioner's stockholders with respect to their stock since no issue of a claimed deduction for a charitable contribution is here in issue. Cf. *Crosby Valve & Gage Co.,* 46 T.C. 641 (1966), on appeal (C.A. 1, Jan. 1, 1967).

If property which has appreciated in value is transferred by a taxpayer to discharge an obligation, such taxpayer realizes a gain from the transfer to the extent that the value of the obligation discharged exceeds his basis in the property. A gift of property that has appreciated in value does not result in income to the donor taxpayer, *Humacid Co.*, 42 T.C. 894, 913 (1964), but where property is donated subject to a mortgage the circumstances of the transfer may be such that a gain does result to the donor. *Joseph B. Simon*, 32 T.C. 935 (1959), affd. 285 F. 2d 422 (C.A. 3, 1960). Since the amount of the mortgage on property is part of its sale price even though the purchaser does not assume the mortgage, *Crane* v. *Commissioner*, 331 U.S. 1 (1947), on the theory that the purchaser will be required in some way to discharge the mortgage, a transfer of property subject to a mortgage may be in substance a receipt by the transferor of the amount of the mortgage on the property if the transferee does in fact pay the indebtedness secured by the mortgage. See *Joseph B. Simon, supra.*

Petitioner contends that in the instant case the Foundation did not in fact pay the note secured by the B. G. Wholesale, Inc., stock which petitioner transferred to it. Petitioner states that it contributed "the stock" to the Foundation and not merely "its equity" in the stock. Even though the resolution passed by petitioner's directors was for a contribution of the stock, all petitioner had any ability to contribute at that time was "its equity" in the stock since the stock was pledged with the bank to secure petitioner's note for $750,000. The stock was assigned to the bank in negotiable form. It could not have been transferred to the Foundation without the agreement of the bank. The Foundation left the stock assigned to the bank to secure petitioner's note. Unless petitioner had

either paid the note or put up other collateral satisfactory to the bank which there is no indication in the record it even considered doing at the time of the transfer, the bank would not have temporarily released the stock to permit title to be transferred to the Foundation without the agreement of the Foundation to assign the stock as security for petitioner's note. In substance, accepting petitioner's contention that it made a contribution of the stock to the Foundation in February, 1958, all it did contribute was "its equity" in the stock. Petitioner remained the obligor on the note and ultimately petitioner paid the note with funds which came in effect from the sale of the stock. This indirect advance by the Foundation to petitioner with which petitioner paid the note for which the stock was security occurred after the close of petitioner's fiscal year ended January 31, 1959.

From the time the title to the stock was transferred by petitioner to the Foundation in February, 1958 until March 5, 1959, the Foundation held the stock subject to its assignment to the bank as security for petitioner's loan. After the contract for the redemption of the stock was entered into, the bank continued to hold the stock in assigned form until the note given by B. G. Wholesale, Inc., as part of the redemption price had been paid in full when the bank purchased the B. G. Wholesale, Inc., note from the Foundation and petitioner with $700,000 of the funds from this purchase paid its note for which the stock was security, and the bank transferred the stock from petitioner's account to that of B. G. Wholesale, Inc.

The facts show that all the money which the Foundation received from B. G. Wholesale, Inc., in payment for its stock found its way to petitioner and was used by petitioner to discharge its indebtedness to the bank. The first $250,000 of the payment received from B. G. Wholesale, Inc., which is not directly involved in this case, was

used by the Foundation to pay a debt to the First National Company, all of the common stock of which the Foundation owned directly and most of the preferred stock of which it owned directly or indirectly. The First National Company used the $250,000 as payment on its indebtedness to four companies, all of the outstanding stock of each of which it owned, which four companies forthwith paid the same amounts on their indebtednesses to petitioner. Upon the sale of the B. G. Wholesale, Inc., note which the Foundation received as the remaining portion of the redemption price of the stock, the Foundation advanced $700,000 of the funds received to the First National Company which paid this amount on its indebtedness to three of the same four corporations which then paid petitioner the same amounts on their indebtednesses to petitioner. Petitioner forthwith paid its note to the First American National Bank of Nashville. In substance, the $700,000 which petitioner used to pay the note was part of the redemption price of the stock. The $700,000 was advanced by the Foundation to First National Company which owned all of petitioner's common stock. In form First National Company used the $700,000 to discharge that amount of its indebtednesses to corporations, all the stock of which it owned, and these corporations discharged their indebtednesses to petitioner. In substance the $700,000 was used to pay petitioner's note which was secured by the B. G. Wholesale, Inc., stock. "[B]y this roundabout process petitioner received the same benefit" as though the Foundation had directly paid its note. *Minnesota Tea Co.* v. *Helvering,* 302 U.S. 609 (1938). The Foundation obtained no more advantage from receipt of the $700,000 than it would have obtained had it directly paid petitioner's note except for having on its books $700,000 as an advance to First National Company. There is no showing in the record that First National Company

has or ever intends to repay this advance. We conclude that the intent and plan of petitioner's officers and directors when petitioner transferred the B. G. Wholesale, Inc., stock to the Foundation was that the stock, or proceeds from its sale, would be used to discharge petitioner's note to the First American National Bank of Nashville. Even though petitioner's indebtedness to the bank was not assumed by the Foundation, the Foundation took the stock subject to the indebtedness under such circumstances as to amount to an understanding and agreement that in effect the stock or proceeds from its sale would be used to discharge petitioner's indebtedness to the bank and in effect petitioner sold the stock to the Foundation for the amount of its note which at the time was $750,000.

Since the Foundation indirectly owned 87 percent of petitioner's stock, petitioner's transfer of the stock to the Foundation might be considered to be in the nature of a dividend. Section 311(a) of the Internal Revenue Code of 1954[1] codifies the generally accepted law under the 1939 Code, that a corporation realizes no gain or loss upon the distribution of property with respect to its stock. However, one of the exceptions to this general rule is contained in section 311(c)[2] which provides that if a corporation dis-

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1. SEC. 311. TAXABILITY OF CORPORATION ON DISTRIBUTION.

(a) General Rule.—Except as provided in subsections (b) and (c) of this section and section 453 (d), no gain or loss shall be recognized to a corporation on the distribution, with respect to its stock, of—

(1) its stock (or rights to acquire its stock), or

(2) property.

2. Sec. 311(c) Liability in Excess of Basis.—If—

(1) a corporation distributes property to a shareholder with respect to its stock,

(2) such property is subject to a liability, or the shareholder assumes a liability of the corporation in connection with the distribution, and

tributes property to a shareholder with respect to its stock, such property is subject to a liability and the amount of such liability exceeds the adjusted basis of such property in the hands of the distributing corporation, gain shall be recognized to the distributing corporation in an amount equal to such excess as if the property distributed had been sold at the time of the distribution.

If petitioner's transfer of its stock to the Foundation were considered to be in substance a distribution of a dividend to the indirect owner of 87 percent of its stock as distinguished from a contribution, the language of the Statute would require the recognition of a capital gain at least to the extent determined by respondent.

Petitioner's contention that the stock was transferred to the Foundation to enable the Foundation to receive dividends is unimpressive since the clear inference from the record is that petitioner's management was aware of the likelihood of the stock being disposed of in the near future if the owner of the stock insisted on reasonably high dividends. The lack of any intention to assist the corporation, at least to the extent of the amount of petitioner's note for which the B. G. Wholesale, Inc., stock was security, is indicated by the immediate advance of $700,000 of the funds the Foundation received upon the sale of the B. G. Wholesale, Inc., note to the bank to First National Company from which the $700,000 found its way to pay petitioner's note. The same day the Foundation sold the B. G. Wholesale,

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(3) the amount of such liability exceeds the adjusted basis (in the hands of the distributing corporation) of such property,

then gain shall be recognized to the distributing corporation in an amount equal to such excess as if the property distributed had been sold at the time of the distribution. In the case of a distribution of property subject to a liability which is not assumed by the shareholder, the amount of gain to be recognized under the preceding sentence shall not exceed the excess, if any, of the fair market value of such property over its adjusted basis.

Inc., note to the bank, petitioner's note to the same bank was paid by a portion of the funds from the sale.

We agree with respondent that the substance of the transaction whereby petitioner transferred the stock to the Foundation was a sale by petitioner of the stock for an amount of at least $700,000. We therefore sustain respondent's determination that petitioner realized a capital gain in this amount from the transfer of the B. G. Wholesale, Inc., stock to the Foundation in its fiscal year ended January 31, 1959.